Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
BellSouth and Bell Atlantic Petition for	)	
Rulemaking to Amend Part 32 of the	)	
Commission's Rules,	)	RM 9341
Uniform System of Accounts for Class A	)	
and Class B Telephone Companies to Adopt	)	
the Accounting for Software Required	)	
by Statement of Position 98-1	)	

BELLSOUTH AND BELL ATLANTIC REPLY COMMENTS

BellSouth Corporation and BellSouth Telecommunications, Inc. ("BellSouth") and the Bell Atlantic telephone companies[1] ("Joint Petitioners") filed their Petition in this proceeding requesting the Commission to amend its existing Part 32 rules concerning the Uniform System of Accounts for Telecommunications Companies in order to accommodate recent changes in Generally Accepted Accounting Principles ("GAAP") adopted in Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use ("SOP 98-1"). While all the commenters supported the Joint Petition these reply comments respond to unwarranted suggestions made by a single party.

MCI filed comments in support of the Petition to revise Part 32 to conform to SOP 98-1. However, included in MCI's comments are requests that the Commission impose unnecessary and burdensome regulation for its implementation. MCI's comments seek to have local

[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, DC, Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

exchange carriers ("LECs") saddled with additional regulation for the sake of regulation. Joint Petitioners strongly urge the Commission to adopt the Petition without the additional requirements suggested by MCI.

Moreover, MCI urges the Commission to summarily deny the Joint Petitioners' request for waiver of a revenue requirement study. MCI contends that "costs still matter" and that the effect of the change "could be substantial." As the Commission has repeatedly acknowledged, however, price cap regulation "severs the direct link between regulated costs and prices." *Implementation of the Non-Accounting Safeguards of Sections 271 and 272*, 11 FCC Rcd 18877, 18942 (1996) (quoting *Computer III Remand Proceedings*, 6 FCC Rcd 7571, 7596 (1991)). Any suggestion that there is a revenue requirement associated with this accounting change completely ignores the effect of price cap regulation.

MCI concurs with the Petition that certain software should be classified as intangible. MCI, however, would have the Commission issue rules that require software to be distinguished between initial operating software and application software. MCI proposes to continue to require initial operating software be classified as a tangible asset and amortized over the life of the associated hardware that it runs on and would classify application software as an intangible asset and assign it an independent life for amortization even though the application software runs on the same equipment. This form of inconsistency is exactly what the Petition seeks to avoid.[2] There is no reason to distinguish between application and initial operating software. Both types of software have the same physical properties and can not be differentiated except for the instructions they direct the computer to perform. Moreover, recent technology for operating

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[2] The LECs will not distinguish between operating and application software for GAAP purposes. Thus, such a requirement would cause further differences between the regulated and the GAAP books.

systems for most types of hardware is developing as rapidly as application software (e.g. Windows 95 and Windows 98). The life for operating system software should therefore not exceed the life of initial application software developed or purchased. This is especially true in today's environment where both the initial operating and application software are typically developed or purchased as a complete package. In such cases the cost for the two cannot be distinguished and an estimate must be made in order to allocate a portion of the cost to the hardware asset account and a portion to the intangible asset account. This distinction is not a GAAP requirement. Indeed, SOP 98-1 makes no mention of different accounting requirements or otherwise distinguishes between the operating and application portions of integrated software. Moreover, adoption of MCI's recommendation will result in carriers being required to continue the arbitrary assignment of the cost of software packages between application and operating systems software or rely on vendors to do the assignment. Rejection of MCI's proposal will enable carriers to discontinue this practice.

MCI's premise for seeking to have operating system software continued to be classified as a tangible asset is logically flawed. MCI claims that such costs should continue to be treated as tangible to ensure that cost allocations between regulated and unregulated "remain undisturbed and straight-forward" to prevent cross-subsidization. But a LEC can allocate software costs to regulated or non-regulated from the intangibles account. Capitalizing a portion of the software costs to tangible assets, while placing another portion in intangible assets will not facilitate cost allocation for regulatory purposes. Moreover, even if capitalizing initial operating software as a tangible asset did facilitate the allocation process of the costs between regulatory and non-regulatory, such allocation no longer impacts rates for a price cap LEC. Consequently, the additional rules will not add any protection against cross-subsidization. Accordingly, the

creation of burdensome distinctions in the categorization of portions of the software between tangible and intangible is inconsequential and not needed.

Moreover, this process should not be complicated by further overlaying dollar limit rules on initial operating software as opposed to other types of software. As set forth in the Petition, all software below a $2,000 threshold should be expensed. Such items should be deemed to be the normal operating expense of the LECs even if the items prove to have a life greater than one year. In contrast, MCI urges the Commission to capitalize all initial operating software, even the items with a cost of less that $2,000. Furthermore, MCI contends that the LECs must analyze every personal computer purchased and determine if initial operating software caused the cost to exceed $2,000. Under such regulation, the LECs would have to analyze every transaction involving software to determine if any portion of the cost meets the requirements of constituting initial operating software. This is exactly the type of micro-management the Commission should be seeking to eliminate. There is no public interest in requiring a carrier regulated under price caps to undertake the burdensome and costly task of maintaining asset and depreciation records for such inexpensive items.

In the Public Notice the Commission sought comment on "whether the Commission should prescribe ranges of amortization periods for the different types of software, and if so, the appropriate amortization periods for the different types of software." MCI comments that the Commission should prescribe ranges and suggests that the ranges associated with depreciation parameters as the ranges that should control. The Petition, however, did not seek to change the current Part 32 rules regarding these issues. Indeed, Part 32 adequately addresses amortization periods and needs no modification to comply with SOP 98-1.

The useful life of software is subject to a number of external factors such as regulatory requirements, technology changes, competition, and vendor restrictions. Some software has a disparate need for periodic replacement or upgrading, while other types do not. Accordingly, a constant review and evaluation of the assigned estimated useful lives are necessary. Assignment of specific amortization periods would only frustrate this process.

The current Part 32 rules regarding amortization properly reflect the flexibility needed in establishing amortization periods and permits carriers to determine the estimated useful life based on either "upper or lower limits."[3] Moreover, the rule leaves the determination of the upper or lower limit and the determination of which limit to use as the amortization period to the carrier. The only absolute requirement is that the period of amortization can be no more than forty years.

SOP 98-1 follows the same form of guidelines in establishing amortization periods for software. It dictates that "[t]he cost of computer software ... should be amortized on a straight line basis unless another systematic and rational basis is more appropriate," and, just as in Part 32, does not prescribe specific amortization periods:

> In determining and periodically reassessing the estimated useful life over which the costs incurred for internal-use computer software will be amortized, entities should consider the effects of obsolescence, technology, competition, and other economic factors. Entities should consider rapid changes that may be occurring in the development of software products, software operating systems, or computer hardware and whether management intends to replace any technologically inferior software or hardware. Given the history of rapid changes in technology, software often has had a relatively short useful life.[4]

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[3] 47 C.F.R. § 32.2000(h).

[4] SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, ¶ 37.

SOP 98-1 recognizes that software has a history of rapid change and has had a relatively short useful life. For this reason, it establishes guidelines to follow when determining amortization periods. It does not, however, establish upper or lower limits or a maximum amortization period. Instead, the Appendix to SOP 98-1 states "AcSEC decided not to specify a maximum amortization period because each entity is better able to determine an appropriate useful life."[5] This flexibility in consistent to that afforded carriers under Part 32 and therefore no modification is needed.

Finally, the Petition requests the Commission to advance the proceedings regarding the rulemaking on an expedited basis. The Public Notice of the Petition elicited comments from several parties. Although, MCI opposed requested procedures to implement the rules change none of the parties opposed the Petition. Moreover, the comments provided by the parties established a thorough and complete record regarding procedures for implementing the rules change. Therefore, in accordance with 47 C.F.R. §§ 1.412(c) and 1.407, Joint Petitioners contend that a notice of proposed rulemaking is unnecessary and the Commission should issue a final order adopting the rules change pursuant to the procedures set forth in the Petition.

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[5] *Id.* ¶ 88

Conclusion

The Commission should adopt rules to implement the Joint Petition as filed.

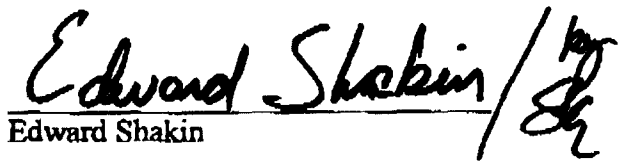
Respectfully submitted,

M. Robert Sutherland
Stephen L. Earnest

Suite 1700
1155 Peachtree Street, N.E.
Atlanta, GA 30309-3610

(404) 249-2608

Attorneys for
BellSouth Corporation and
BellSouth Telecommunications, Inc.



Edward Shakin

1320 North Court House Road
Eighth Floor
Arlington, VA 22201

(703) 974-4864

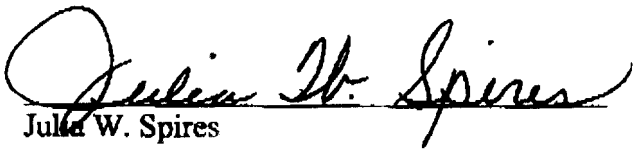
Attorney for the
Bell Atlantic Telephone Companies

Michael E. Glover
Of Counsel

Date: September 28, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this 28th day of September 1998, serviced all parties to this action with the foregoing ***BELLSOUTH AND BELL ATLANTIC REPLY COMMENTS***, reference RM 9341, by hand service or by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties as set forth on the attached service list.



Julia W. Spires

Service List RM-9341

Secretary**
Federal Communications Commission
1919 M Street, N.W. Room 222
Washington, DC 20554

Brett Kissel**
Accounting Systems Branch
Accounting Safeguards Division
Federal Communications Commission
1919 M Street N.W.
Washington, DC 20554

International Transcription Service**
1231 20th Street, N.W.
Washington, DC 20036

Kathryn C. Brown**
Chief, Common Carrier Bureau
Federal Communications Commission
Room 500
1919 M Street, N.W.
Washington, DC 20554

Kenneth P. Moran**
Chief, Accounting Safeguards Division
Room 812
Federal Communications Commission
200 L Street, N.W.
Washington, DC 20554

James Schlichting**
Common Carrier Bureau
Federal Communications Commission
Room 500
1919 M Street, N.W.
Washington, DC 20554

Don Sussman, Regulatory, Analyst
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Lawrence E. Sarjeant
Linda L. Kent
Keith Townsend
John W. Hunter
Attorneys for United States Telephone Association
1401 H Street, N.W. - Suite 600
Washington, DC 20005

John R. Raposa, Esq.
Attorney for GTE Service Corporation
600 Hidden Ridge, HQE03J27
P. O. Box 152092
Irving, TX 75015-2092

Andre J. Lachance, Esq
Attorney for GTE Service Corporation
1850 M Street, N.W.
Washington, DC 20036

David L. Meier, Directory
Regulatory Affairs
Cincinnati Bell Telephone Company
201 E. Fourth Street
P. O. Box 2301
Cincinnati, Ohio 45201-2301

Robert D. Shank
Frost & Jacobs LLP
2500 PNC Center
201 East Fifth Street
Cincinnati, Ohio 45202

Thomas E. Taylor
Sr. Vice President - General Counsel
Cincinnati Bell Telephone Company
201 East Fourth Street, 6th Floor
Cincinnati, Ohio 45202

Leander R. Valent
Counsel for Ameritech
9525 W. Bryn Mawr, Suite 600
Rosemont, Illinois 60018

Robert M. Lynch
Durward D. Dupre
Darryl W. Howard
Jonathan W. Royston
Attorneys for Southwestern Bell Telephone Company
Pacific Bell, Nevada Bell
One Bell Plaza, Room 3022
Dallas, TX 75202

**HAND SERVICE